



DEPARTMENT OF
FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

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January 24, 2006

Ms. Greta Wallace, Director
California Department of Child Support Services
P.O. Box 419064
Rancho Cordova, CA 95741-9064

Dear Ms. Wallace

Final Report—California Department of Child Support Services 2005 Internal Control Review

Enclosed is our final report on the review of the California Department of Child Support Services' (Department) internal control as of October 12, 2005. The Department of Finance, Office of State Audits and Evaluations (Finance), performed this review in accordance with the Financial Integrity and State Manager's Accountability Act of 1983, Government Code Section 13400 et seq.

In accordance with Finance's policy of increased transparency, the final report will be placed on the Finance website. We appreciate the assistance and cooperation of Department staff and management during our review. If you have any questions regarding this report, please contact Kim Tarvin, Manager, or Mary Camacho, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by Diana L. Ducay

Diana L. Ducay, Chief
Office of State Audits and Evaluations

Enclosure

cc: Ms. Olivia Cortez, Deputy Director, Administrative Services Division, California
Department of Child Support Services
Mr. Kenji Okimoto, Chief, Financial Services Branch, Administrative Services Division,
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Child Support Services

AN INTERNAL CONTROL REVIEW

California Department of Child Support Services

Prepared By:
Office of State Audits and Evaluations
Department of Finance

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The mission of the California Department of Child Support Services (Department) is to promote the well-being of children and the self-sufficiency of families by delivering child support establishment, collection, and distribution services that help both parents meet the financial, medical, and emotional needs of their children.

The Department, established pursuant to California Family Code, Section 17200, began its operation in January 2000. The Department is the single state agency designated to administer the Title IV-D state plan. The Department ensures that all functions necessary to establish, collect, and distribute child support to custodial parents are efficiently implemented. The Department estimates child support payment collections of \$2.4 billion in 2004-05. Approximately \$1.7 billion will go directly to families, while the remaining collections provide revenues in the form of recoupment of previously incurred welfare costs to federal, state, and local governments. The Department receives funding from the State General Fund and the Federal Trust Fund.

Our internal control review objective was to assist the Department in complying with the Financial Integrity and State Manager's Accountability Act of 1983. Management is responsible to establish and maintain internal and administrative controls to comply with the aforementioned. Elements of a satisfactory system of internal accounting and administrative control include, but are not limited to: (1) reliable financial reporting; (2) safeguarding of state assets; and (3) compliance with State Administrative Manual guidelines, other state laws and regulations, and Department plans, policies, and procedures. Internal accounting and administrative control is further defined to include these five interrelated components:

- *Control Environment* sets the tone of an organization, influencing the control consciousness of its staff. It is the foundation for all other internal control components, providing discipline and structure.
- *Risk Assessment* is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.
- *Control Activities* are the policies and procedures that help ensure management directives are carried out.
- *Information and Communication* are the identification, capture, and exchange of information in a form and time frame that enable staff to carry out their responsibilities.
- *Monitoring* is the process that assesses the quality of internal control performance over time.

Our review provided adequate information based upon interviews, observations, discussions, substantive testing, and analysis, for us to provide an opinion on the overall effectiveness of internal control activities conducted by the Department.

This report is intended for the information and use of the Department and should not be used for any other purpose. However, the report is a matter of public record and its distribution is not limited.

STAFF:

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Manager

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EXECUTIVE SUMMARY

During our review of the Department's internal control as of October 12, 2005, we identified areas where controls were in place and working as intended, and also identified areas where controls could be improved to reduce the risk of errors, irregularities, and material misstatements. Our findings and observations are summarized below, for further analysis refer to the Findings and Recommendations section of this report.

Administrative Controls: The Department's documentation of policies and procedures are not sufficient to ensure proper control and accountability over the operations of the Department. Specifically, we noted: (1) inadequate documentation of policies and procedures for budgeting, receivables, purchasing, revolving fund, contracts, and fixed assets; (2) inadequate separation of duties over various accounting and fixed asset management functions; (3) reconciliations not being performed on a regular basis; and (4) inadequate documentation of signature authorization over purchasing and contracts.

Information Technology: The Department's information technology controls appear adequate to ensure the overall reliability and integrity of data. However, we observed the following: (1) inadequate separation of duties; (2) improper computer lockout procedures; and (3) inadequate Risk Management Analysis and Risk Management Certification.

Budget: The Department's controls over its budget functions appear adequate to ensure the reliability and integrity of data. The Department's budget is developed through input and review from various members of management and the Department of Finance. However, the policies and procedures over the budget process are not documented.

Cash Receipts: The Department's cash receipts controls appear adequate to ensure assets are properly safeguarded. We observed that the daily remittances are submitted to the State Treasurer's Office timely and that access to the safe is properly restricted to safeguard valuable property. However, we noted that there was no supervisory review of deposits.

Account Receivables: The Department's controls are not sufficient to ensure that receivables are established for amounts due, are billed timely, and adequate collection efforts are made on outstanding receivables. We noted the following weaknesses: (1) inadequate documentation of policies and procedures; (2) inadequate separation of duties; (3) contingency receivables due from counties are not established; and (4) inadequate collection procedures for employee receivables.

Purchasing: The Department's purchasing controls appear adequate to ensure that the Department acquires only those goods and services that are authorized and necessary for effective operations. However, we noted the following weaknesses: (1) inadequate documentation of policies and procedures; (2) inadequate documentation of authorization signatures; and (3) invoices being approved for payments without receiving documents.

Cash Disbursements: The Department's cash disbursements controls appear adequate to ensure that assets are appropriately safeguarded. We observed that updated authorizations are maintained, bank reconciliations are performed on a regular basis, and blank check stocks are properly safeguarded. However, we noted that separation of duties over the cash disbursement process are inadequate.

Revolving Fund: The Department's revolving fund controls appear adequate to ensure state assets are safeguarded. We noted that the revolving fund advances are less than three percent of the Department's budget; the fund has not been consistently overdrawn; and that travel and salary advances are appropriately issued and are cleared timely. However, we noted that the policies and procedures over the uncollectible salary advances are not documented.

Payroll/Personnel: The Department's controls over the personnel and payroll functions appear adequate. We observed that there are adequate procedures for the hiring and reestablishing abolished positions, and personnel records are properly maintained and authorized. However, we noted the following weaknesses: (1) inadequate separation of duties; (2) incomplete employee separation process; and (3) employee leave balances exceeding maximum allowable hours.

Contracts: The Department's contracting controls appear adequate. We observed that contracts are properly maintained. However, we noted the following weaknesses: (1) inadequate documentation of policies and procedures; (2) inadequate documentation of authorization signatures; and (3) noncompliance with State Contract Manual requirements.

Fixed Assets: The Department's fixed asset controls are not sufficient to ensure the appropriate safeguarding of state assets. Our review identified several weaknesses: (1) policies and procedures over fixed assets in inventory, tagging, dispositions, or reconciliations are not properly documented; (2) inadequate separation of duties over Information Technology assets; and (3) inadequate controls over fixed assets in the following areas: physical inventory, reconciliations to the general ledger, property tagging, and the absence of a formalized list of Property Survey Board members.

Financial Reporting: The Department's financial reporting controls appear adequate. We observed that required financial statements are properly prepared, certified, and submitted timely. However, we noted that reconciliations are not performed on a regular basis.

This report is intended to assist Department management in focusing attention on areas of deficiency, strengthening internal control, and improving operations.



AUDITOR'S REPORT

Ms. Greta Wallace, Director
California Department of Child Support Services
P.O. Box 419064
Rancho Cordova, CA 95741-9064

We have reviewed the California Department of Child Support Services' (Department) internal control as of October 12, 2005, for conformity with Government Code Section 13400 et seq. Our review included obtaining an understanding of the Department's internal control through observations and interviews, testing and evaluating the design and operating effectiveness of the internal control, and performing other procedures we considered necessary.

The Department's management is responsible for establishing and maintaining adequate internal control. This responsibility, in accordance with Government Code Section 13400 et seq., includes documenting internal control, communicating requirements to employees, and assuring that the internal control is functioning as prescribed. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of internal control are to provide reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition.
- Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements.
- Financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual.

Because of inherent limitations in internal control, misstatements due to error or fraud may occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

In reviewing the Department's internal control as of October 12, 2005, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. A material weakness is a condition that precludes the Department's internal control from providing

reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis. We believe that none of the reportable conditions is a material weakness. The reportable conditions are described in the *Findings and Recommendations* section of this report.

This report is intended solely for the information and use of Department management and is not intended to be and should not be used by anyone other than this specified party. However, this report is a matter of public record and its distribution is not limited.

Original signed by Diana L. Ducay

Diana L. Ducay, Chief
Office of State Audits and Evaluations

October 12, 2005

FINDINGS AND RECOMMENDATIONS

During our review of the California Department of Child Support Services (Department) internal control as of October 12, 2005, we noted that most controls were functioning as intended. However, we also identified several areas where controls are either not in place or not functioning as intended, and where corrective action is necessary. If left uncorrected, these weaknesses could compromise the accuracy of the Department's financial operations and financial statements.

Administrative Controls

Administrative or management controls relate to operational efficiency, adherence to managerial policies, and management's authorization of transactions. Department management is responsible for overseeing activities conducted within their agencies. This responsibility includes the establishment and maintenance of internal accounting and administrative controls over operations. We identified the following weaknesses in the Department's administrative controls. These weaknesses significantly increase the risk that the Department's assets may be misappropriated and that the financial statements may be misstated.

FINDING 1 Inadequate Documentation of Policies and Procedures

Condition: The Department does not maintain adequate documentation describing the policies and procedures associated with the following areas:

- No written documentation of the budget functions.
- No written procedures for establishing contingency receivables, writing-off account receivables, monitoring outstanding account receivables, and review of receivables.
- Lack of written documentation for purchasing procedures, including receiving of goods, errors/missing items, over shipments, invoice approval, invoice disputes, amendments, and documentation.
- Lack of documentation over the revolving fund concerning uncollectible salary advances.
- Lack of written documentation over contract functions, including procedures for formal competitive bid requests and post award activities.
- Lack of written documentation over the fixed asset cycle for inventory, tagging, dispositions, and reconciliations.

We observed that many policies and procedures are not documented and those which are documented, are not formalized in a Department approved manual. Failure to adequately document and maintain current policies and procedures in the Department approved manual increases

the risk of inconsistencies and errors within operational processes as well as diminishes the Department's training effectiveness should a turnover in staff occur.

Criteria: State Administrative Manual (SAM), Section 20050 states that the elements of a satisfactory system of internal accounting and administrative controls, shall include a system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues and expenditures.

Recommendation: Ensure all operational processes and procedures are appropriately documented, revised periodically, and maintained in a centralized manual.

FINDING 2 Inadequate Separation of Duties

Condition: The Department has not maintained adequate separation of duties over various accounting and fixed asset management functions, thereby increasing the risk of misappropriation.

- A. The same staff that are authorized to sign checks also have access to the safe containing the blank check stock.
- B. The Information Technology (IT) Manager with the Information Systems Division performs the following incompatible duties:
 - Receives IT orders
 - Maintains or has access to subsidiary ledger of IT assets
 - Tags IT equipment
 - Authorizes disposal of IT assets and maintains the key to the storage area for planned disposed assets.
- C. The employee who establishes accounts receivable in the CALSTARS system is also a backup check writer. In the absence of the primary check writer, an inadequate separation of duties could exist.
- D. The employee who establishes accounts receivable is also a backup for receipt functions and performs account receivable monthly reconciliations.
- E. In three units, the primary Payroll Custodian, who processes payroll documents, was also the alternate attendance coordinator, charged with picking up warrants. Consequently, the Payroll Custodian could enter timesheets and pick up the warrants in the absence of the primary attendance coordinator.

Criteria: SAM Section 8080 states that the staff comparing machine-signed checks with authorizations and supporting documents (or signing checks manually after personally comparing them with authorizations and supporting documents) will not have access to or control the blank check stock.

SAM Section 8080.1 provides the appropriate level of separation of duties for agencies, and allows that employees of other units can be used when necessary to provide for separation of duties.

SAM Section 8652 states that the person in charge of the stockroom, if one is used, will not be in charge of maintaining the inventory records or the taking of physical inventories.

SAM Section 8580.1 lists the personnel documents that should not be processed by persons designated by agencies to receive salary warrants from SCO, distribute salary warrants, or handle salary warrants for any other purpose. Departments must review duties at least semiannually, or more often if necessary, to comply with this section.

- Recommendations:
- A. Separate the duties of access to blank check stock from check signing.
 - B. Separate the asset management duties among several employees or develop mitigating controls.
 - C. Assign a backup check writer who does not perform incompatible duties.
 - D. Reassign backup receipt duties to an employee who does not perform incomparable duties.
 - E. Ensure that the primary attendance coordinator is not the primary or alternate payroll custodian.

FINDING 3 Reconciliations Are Not Performed Regularly

Condition: Reconciliations that attest to the accuracy of accounting records are not performed on a regular basis. Therefore, there is a greater risk that the accounting records are inaccurate.

- A. SCO/CALSTARS reconciliations are not performed on a monthly basis.
- B. Subsidiary records are not reconciled to the general ledger (uncleared collection account) on a monthly basis.
- C. Subsidiary records for Judicial Council advances are inaccurate and do not reconcile to the general ledger expenditure account; this could affect prepayments of expenditures.

Criteria: SAM Section 7901 states that the accuracy of an agency's accounting records may be proved partially by making certain reconciliations and verifications. Reconciliations must be completed between the agency accounts and the accounts maintained by the SCO to disclose errors as they occur. Corrections to errors should be made before financial reports are prepared to partially ensure the accuracy of an agency's financial reports. Properly prepared reconciliations also help to audit the agency's accounting records.

All reconciliations will be prepared monthly within 30 days of the preceding month, with the exception of property reconciliations, and be retained at least two years. Thereafter, destroy after audit or four years, whichever occurs first.

SAM Section 7921 states that Agencies will reconcile their accounts with the like accounts maintained by the SCO. This includes prior fiscal year appropriations that are no longer available for encumbrance but have not reverted.

The SCO provides monthly an Agency Reconciliation Report to agencies in order to reconcile their account balances. For each account, the report displays the beginning balance, transactions that occurred during the month, and the ending balance. The reconciliation will detail differences between the SCO and agency records. Agencies will attempt to resolve reconciling items timely to prevent significant differences at year-end.

SAM Section 7800 states the form and content of subsidiary records may vary among agencies except as specifically described in other chapters. These records will be reconciled to the General Ledger monthly.

- Recommendations:
- A. Perform SCO/CALSTARS reconciliations on a monthly basis within 30 days of the preceding month to prevent long-outstanding differences.
 - B. Perform reconciliations between subsidiary records and the general ledger uncleared collections account on a monthly basis.
 - C. Perform reconciliations between manual tracking of Judicial Council expenditures to the general ledger expenditure account on a monthly basis.

FINDING 4 Inadequate Documentation of Authorization Signatures

Condition: The Department does not have a list of Department staff authorized to approve purchases, purchase adjustments, and contracts for goods and services. The Department has documentation specifying the positions authorized to sign official documents, but the documentation does not specify the names of the authorized staff. Consequently, there is an increased risk that contract documents are signed by unauthorized personnel.

Criteria: SAM Section 1208 states that authority to sign contracts is limited to those officers who either have statutory authority or have been duly authorized in writing by one who has statutory authority.

Recommendation: Establish, maintain, and update a list of Department staff that are authorized to approve purchases, purchase adjustments, and contracts for goods and services.

Account Receivables

Effective internal control over the account receivable process is necessary to ensure that controls are established for amounts due, amounts are billed timely, and adequate collection efforts are made on outstanding receivables. We observed weaknesses in the Department's internal control over receivables. These weaknesses significantly increase the risk that receivables are not accounted for properly.

FINDING 5 Contingency Receivables Due From Counties Are Not Established

Condition: The Department does not establish a receivable in CALSTARS for contingency receivables due from county audit findings. The Department records any collection of contingency receivables from counties as revenue. Consequently, the Department is unaware of all receivables due.

Criteria: SAM Section 8776.12 states that contingency receivables will be recognized in the accounts at the time the claim arises.

Recommendation: Ensure all receivables are properly recorded in the Department accounting records.

FINDING 6 Inadequate Collection Procedures for Employee Account Receivables

Condition: Employee account receivables are not timely cleared. All of the five employees or separated employees receivables tested were over 120 days old. Of the five tested, two employees have separated from the state and required three collection letters to be sent. However, the separated employees were only sent two of the required three collection letters. When we notified the Department it completed the third letter for one of the two separated employees. In addition, the Department does not have account receivables write-off procedures, which has enabled accounts receivables to remain in the accounting records for several years. Consequently, employee account receivables remain outstanding.

Criteria: SAM Section 8776.6 details the collection procedures and guidelines departments should use for the collection of amounts owed to the state from non-employees.

SAM Section 8776.7 states that Government Code Section 19838 requires reimbursement to the state of overpayments made to employees. Recoupment action must be initiated (written notification of overpayment to the employee) within three years from the date of overpayment in order to collect without the employee's consent, as provided in these procedures.

Recommendation: Ensure all receivables are properly monitored and that appropriate action is taken.

In addition, we identified inadequate documentation of policies and procedures over the account receivable cycle as noted in Finding 1 and inadequate separation of duties as described in Finding 2.

Fixed Assets

Effective internal controls safeguard property, plant, and equipment from unauthorized acquisition, use, or disposition. We identified the following material weaknesses in internal control over the Department's fixed assets. These weaknesses significantly increase the risk that the Department's property may be misappropriated.

FINDING 7 Inadequate Controls Over Fixed Assets

Condition: There is a lack of accounting and physical controls over fixed assets.
Specifically:

- A. The Department's physical inventory procedures are inadequate. The Department's assets fall into two categories: Information Technology (IT) assets and non-IT assets.
- There is no property listing for non-IT assets. There is no evidence that the Department performed an inventory on non-IT assets since the Departments inception in January 2000.
 - Current procedures for the inventory of IT assets entails making changes directly to the assets computer database file; therefore, there is no documented trail of the inventory performed and changes made to the previous inventory count.

Consequently, there is an increased risk that property may not be adequately accounted for.

- B. The Department does not perform reconciliations of the physical inventory to a capitalized fixed asset subsidiary ledger, and to the General Fixed Assets general ledger. Of six IT assets tested for posting to the IT subsidiary ledger, one item, was not included on the IT subsidiary ledger, but was included in a capitalized fixed assets subsidiary ledger.

Consequently, there is an increased risk that the Statement of General Fixed Assets may not be reported accurately.

- C. The Department's policies and procedures for equipment property tagging are inadequate. Specifically:
- The Department's internal policy requires tagging of IT items over \$250 and non-IT items over \$500.
 - The IT Unit is responsible for tagging all equipment, but is not informed of items requiring tagging. Therefore there is inconsistency in the tagging of assets. Three of the four electronic whiteboards tested were not tagged.
- D. The list of who is on the Property Survey Board is not documented. Consequently, three of the four (75 percent) Property Survey Reports tested were not appropriately signed by authorized staff.

Criteria: SAM Section 8652 states that the Department will make a physical count of all property and reconcile the count with accounting records at least once every three years. It further states that worksheets used to take inventory will be retained for audit and will show the date of inventory and the name of the inventory taker.

SAM Section 8650 states that the department will keep track of state property, whether capitalized or not, in an automated property accounting system (if one is used) or on Property Record Cards form.

SAM Section 8651 states that all state property will be tagged after acquisition. This includes property, which does not meet all of the state's capitalization requirements.

SAM Section 3520.2 states that each agency will have a fully appointed Property Survey Board. It will be the responsibility of the Board to determine that the best interest of the state is served in disposition of state property.

Recommendation: A. Perform and document an inventory on all Department property once every three years.
B. Ensure the physical inventory is reconciled to subsidiary ledgers and to the Statement of General Fixed Assets general ledger.
C. Institute property tagging policies and procedures that comply with SAM requirements to tag all property, including non-IT items, with sequentially numbered property tags. Business Services should identify property ordered that requires property tags.
D. Formalize a list of the Property Survey Board members and provide the list to employees who complete the property survey reports.

In addition, we identified inadequate documentation of policies and procedures over the contracts as noted in Finding 1 and inadequate separation of duties over fixed assets as noted in Finding 2.

Information Technology

Effective internal control over the information technology process is necessary to ensure that controls are adequate for data integrity to prevent unauthorized users from accessing records and manipulating data. We identified the following weaknesses in the Department's internal control over information technology.

FINDING 8 Inadequate Risk Management Analysis and Reporting

Condition: The Department does not maintain written documentation of Risk Management Analysis or the Risk Management Certification. Consequently, the Department is not in compliance with the SAM IT security related reporting requirement. The lack of a Risk Analysis could have a significant negative impact on the fiscal or legal integrity of state operations; or on the continuation of essential agency programs.

Criteria: SAM Section 4842.1 requires each state agency that employs information technology to establish a risk analysis process to identify and assess risks associated with its information assets and define a cost-effective approach to managing such risks. Agencies should complete the comprehensive risk analysis cycle at least every two years and whenever there has been a significant change in their use of information technology. This cycle ends with the preparation of a report documenting the risk assessment.

SAM Section 4845 requires each state agency to submit Risk Management Certification by January 31 of each year, or as instructed by Finance. The director of each agency must certify that the agency is in compliance with state policy governing information technology risk management by submitting the Risk Management Certification.

Recommendation: Contact Department of Finance's Office of Technology Review Oversight and Security to obtain advice in completing Risk Management Analysis and reporting the annual Certification.

FINDING 9 Staff Do Not Lock Computers

Condition: Auditor surveyed ten employees at headquarters and noted that not all employees lock their workstations before leaving their work area. Specifically:

- Of employees interviewed, 60 percent stated that they do not lock their computer.
- We observed 60 percent of employee workstations to be unlocked.

Consequently, confidential information and fiscal information are subject to a lack of data integrity. This could lead to unauthorized users accessing electronic records and manipulating data.

Criteria: SAM Section 4841.2 states that each agency must provide for the integrity and security of its automated files and data bases by ensuring that responsibility for each automated file or database is defined with respect to: the designated owner of the information within the agency, custodians of information, and users of the information.

DCSS Information Security Policy requires the employees to lock the computer by using the "Ctrl-Alt-Del" keys when they leave their work area to protect the Department's information assets.

Recommendation: Enforce the Department Information Security Policy to ensure data integrity by locking computers when leaving the workstation.

Budget

Effective internal control over the budget process is necessary to ensure that controls are adequate for the proper development, approval, and recording of the budget. We identified inadequate documentation of policies and procedures over the budget cycle as described in Finding 1.

Cash Receipt

Effective internal control over the cash receipts process is necessary to ensure that controls are adequate to safeguard cash, and to prevent and timely detect any errors or irregularities. We identified the following weakness in the Department's internal control over cash receipts.

FINDING 10 Lack of Supervisory Review of Deposits

Condition: There is no supervisory review of deposits. Consequently, there is an increased risk of misappropriations and misstatements of cash receipts.

Criteria: SAM Section 8032.3 states that except where the supervisor and the person depositing cash are not at the same location, the person supervising the person depositing cash will verify that receipts have been deposited intact and in accordance with SAM Section 8032.1.

Recommendation: Implement a supervisory review of deposits.

Purchasing

Effective internal control over purchasing is necessary to ensure that the Department acquires only those goods and services that are authorized and necessary for effective operations. The following weakness in purchasing controls decreases the Department's ability to effectively acquire necessary goods and services.

FINDING 11 Invoices Approved for Payment without Stock Received Reports

Condition: The Department does not consistently submit stock received reports to the Business Services Division for approval of vendor payments. Specifically, 47 percent of non-CalCard invoices tested, were approved for payment without the corresponding stock received reports. Consequently, there is an increased risk that invoices paid do not correspond to items actually received.

Criteria: SAM Section 8422.1 states that the agency will determine that items invoiced have been received as evidenced by stock received reports prior to the submission of a claim schedule to the State Controller's Office.

Recommendation: Ensure stock received reports are prepared upon receipt of goods and submitted to the Business Services Division for approval of invoice payments.

In addition, we identified inadequate documentation of policies and procedures over purchasing as noted in Finding 1, and inadequate documentation of authorized signature as discussed in Finding 4.

Cash Disbursements

Effective internal control over the cash disbursement process is necessary to ensure that controls are adequate to safeguard cash, and to prevent and timely detect any errors or irregularities. We identified inadequate separation of duties in the Department's internal control over cash disbursements as noted in Finding 2.

Revolving Fund

The Department's revolving fund is intended for the payment of travel, salary, and expense advances, or where immediate expense payment is otherwise necessary. We identified inadequate documentation of policies and procedures in the Department's internal control over revolving funds as noted in Finding 1.

Payroll/Personnel

Effective internal control over the personnel and payroll functions is required to ensure that Department staff are properly appointed, staff are not separated with outstanding advances or in possession of Department assets, and payroll information is processed accurately and timely. We noted the following weaknesses in the controls over personnel and payroll:

FINDING 12 Incomplete Employee Separation Process

- Condition: The Department does not consistently complete an Employee Separation Package for separating employees. The package provides a method for (1) clearing outstanding advances, (2) ensuring all state property assigned is returned, and (3) ensuring access to electronic data is properly terminated. The Department did not complete a separation package for 8 of 13 separating employees tested. In addition, 2 employee files could not be located.
- Criteria: SAM Section 8580.4 states that salary warrants will not be distributed to terminating employees until the agency is assured that all outstanding travel and salary advances have been paid.
- Recommendation: Require that all separating employees complete the separation package before the employee is cleared to leave the Department. Accounting must ensure that all outstanding advances are cleared and the employees' supervisor must ensure all equipment assigned to the employee is returned. Do not issue warrants to separating employees unless the separation process is completed.

FINDING 13 Employee Leave Balances Exceed Maximum Allowable Hours

- Condition: We tested 34 employees to determine if employees are exceeding maximum leave time allowed. Testing revealed that 3 out of 34 employees, or nine percent, exceeded the maximum number of hours of

vacation/annual leave time allowed. Employees exceeded the maximum amount of accumulated leave time from 48 to 296 hours.

Criteria: Bargaining Unit Contract, Section 8.1J, states that if an employee in Unit 1, 14, or 20 does not use all of the vacation that the employee has accrued in a calendar year, the employee may carry over his/her accrued vacation credits to the following calendar year to a maximum of 640 hours. For bargaining unit 4, the employee may carry over his/her accrued vacation credits to the following calendar year to a maximum of 400 hours.

Recommendation: The Department should monitor employee leave balances on a regular basis to ensure authorized levels are not exceeded. The Department should schedule and enforce vacation schedules for employees exceeding the maximum leave balances allowed.

Contracts

Effective internal control over the contracting function is required to ensure that contracts are properly executed, adequately supported, monitored, and completed. Also, internal controls ensure that competitive bidding requirements are followed, splitting of contracts is avoided, and annual reports are completed. We noted the following weaknesses in the controls over contracting controls.

FINDING 14 Noncompliance with the State Contract Manual Requirements

Condition: The Department did not comply with the State Contract Manual (SCM) requirements. Specifically:

- A. The Department entered into multiple contracts with the same vendor, Positive Impact Consulting, within a 12-month period. The Department did not obtain the Department of General Services (DGS) approval for any of the contracts. Consequently, there is an increased risk that a contract may be split to avoid contracting requirements.
- B. Of the 19 contracts tested, 3 contracts (16 percent), did not have the signature of the contractors:
 - Eclipse Solutions MSA 2-0124.
 - Eclipse Solutions MSA-2-0125-1.
 - Volt Services Group CMA-4-0259-1.Contracts may not have legal validity without proper signature.
- C. The Department does not always submit Standard (STD) Form 16 to the Department of Fair Employment and Housing (DFEH).
 - Two of nineteen contracts tested (10 percent), did not have a corresponding STD Form 16 in their files.
 - Two of nineteen contracts tested (10 percent), did not have a Department official's signature.

Criteria: SCM Section 3.02.4 states that any agency entering into more than one consultant services contract with the same contractor within a 12-month period for an aggregate amount of \$12,500 or more must have DGS approval of each contract that exceeds the \$12,500 aggregate amount.

SCM Section 2.05 states that each contract must contain the signature of a person for each party who is authorized to bind that party.

SCM Section 7.15 states that under Title 2 CCR Section 8117.5, agencies awarding contracts are required to notify DFEH's, Office of Compliance Programs, of any contract awarded in excess of \$5,000. Departments are required to submit one STD 16 to the Office of Compliance Programs for each contract in excess of \$5,000 within ten days of the award date.

Recommendations: A. Ensure that the applicable SCM requirement for multiple contracts with the same vendor is followed.

B. Obtain adequate signatures for legal documents.

C. Ensure that applicable SCM requirements for notifying DFEH are followed.

In addition, we identified inadequate documentation of policies and procedures over the contracts as noted in Finding 1 and inadequate documentation of authorized signature as noted in Finding 4.

Financial Reporting

Effective internal control over financial reporting is required to ensure that both state and federal financial reports are prepared promptly, accurately, and timely. We noted reconciliations are not performed regularly as noted in Finding 3.

CONCLUSION

Our evaluation of the California Department of Child Support Services (Department) internal control presents opportunities for the Department's management to correct identified weaknesses and improve its operations. We believe that internal controls would be strengthened and the Department would operate more effectively if management implements our recommendations. The internal control weaknesses, if left uncorrected, increase the risk that material errors or irregularities could occur and remain undetected.

The findings in this report are based on fieldwork performed between July 11, 2005 and October 12, 2005. We presented these findings to the related divisions and units at the completion of each cycle, at the interim pre-exit meeting, and finally during our exit conference on October 27, 2005.

DEPARTMENT RESPONSE

CALIFORNIA DEPARTMENT OF CHILD SUPPORT SERVICES

P.O. Box 419064, Rancho Cordova, CA 95741-9064



January 6, 2006

Ms. Diana L. Ducay, Chief
California Department of Finance
915 L Street
Sacramento, California 958414-3706

Dear Ms. Ducay:

SUBJECT: DRAFT REPORT – CALIFORNIA DEPARTMENT OF CHILD SUPPORT SERVICES 2005 INTERNAL CONTROL REVIEW

This is in response to your draft report of the review of the Department of Child Support Services' (DCSS) internal control, as of October 12, 2005. The review was performed at the Department's request in accordance with the Financial Integrity and State Manager's Accountability Act of 1983 and provides information to DCSS management about whether controls are established and are functioning as intended.

DCSS understands the necessity of maintaining effective internal control and appreciates the efforts of your staff during this review. Enclosed are DCSS' responses to the findings and recommendations contained in the draft report. We concur with the findings and, as noted in our responses, corrective actions for many of the findings were implemented during the audit. These corrective actions were discussed with the auditors either during the audit or at the exit conference. In addition, in recognition of the importance of documented policies and procedures, DCSS is embarking on the creation of a *DCSS Administrative Manual*. This manual will serve as a central repository of DCSS's administrative policies and procedures. DCSS anticipates completing this manual by fiscal year end 2005/2006.

Thank you for the opportunity to respond. If you have any questions, please contact Cher Woehl, Deputy Director, Administrative Services Division, at (916) 464-5151.

Sincerely,

Original signed by Greta Wallace

GRETA WALLACE
Director

Enclosure

cc: Ms. Mary Kelly, Manager, Department of Finance, Office of Audits & Evaluations

DEPARTMENT OF CHILD SUPPORT SERVICES
 RESPONSE TO DEPARTMENT OF FINANCE
 DRAFT REPORT OF INTERNAL CONTROL AS OF OCTOBER 12, 2005

The following comments are Department of Child Support Services' (DCSS) response to the recommendations contained in the Department of Finance, Office of State Audits and Evaluations, draft report of internal control as of October 12, 2005.

Finding 1 Inadequate Documentation of Policies and Procedures

Recommendation: Ensure all operational processes and procedures are appropriately documented, revised periodically, and maintained in a centralized manual.

Response: DCSS concurs. DCSS is developing or has revised procedures in many of the areas noted in the report. In addition, DCSS is developing a *DCSS Administrative Manual* which will contain departmental administrative policies and procedures. Completion of the manual should occur no later than fiscal year end 2005/2006. The manual will be revised periodically as changes to policies and procedures occur.

- The budget unit is in the process of establishing State Administrative Manual (SAM) compliant policies and procedures for the budget function.
- While SAM does not mandate a centralized department approved manual, we concur with the recommendation to establish written procedures. Procedures establishing, reviewing and monitoring all accounts receivable and contingency receivables were formally established and provided to auditors in October 2005.
- The Business Services Section management is currently reviewing all Business Services processes and procedures, including instructions to departmental program staff, to identify areas that need improvement. The existing *Operating Policies and Procedures Manual - Contracts and Procurement* will be incorporated into the administrative manual.
- The procedures concerning uncollectible salary advances were established and provided to auditors in October 2005.
- The procedures for formal competitive bid requests are contained in the Department's Business Services Section's *Operating Policies and Procedures Manual - Contracts and Purchasing*. The policies and procedures are undergoing review to identify areas that need improvement. Revisions will be incorporated into the administrative manual.
- Property Management procedures, including those regarding fixed asset inventory, tagging, dispositions and reconciliations are currently being finalized and reviewed for inclusion in the administrative manual. In addition, an inventory of the Department's non-IT assets was initiated during the review and subsequently completed.

Finding 2

Inadequate Separation of Duties

Recommendation: Ensure adequate separation of duties over accounting and fixed asset management functions is maintained. Specifically:

- A. Separate the duties of access to blank check stock from check signing.
- B. Separate the asset management duties among several employees or develop mitigating controls.
- C. Assign a backup check writer who does not perform incompatible duties.
- D. Reassign backup receipt duties to an employee who does not perform incomparable duties.
- E. Ensure that the primary attendance coordinator is not the primary or alternate payroll custodian.

Response: DCSS concurs and has implemented the recommendation.

- A. In November 2005, changes were submitted to CALSTARS ensuring DCSS no longer has employees with access to blank check stock and the ability to sign checks. The safe combination was changed in December 2005.
- B. The Technology Services Division has separated the IT asset management duties by assigning responsibilities to three different managers.
- C. In November 2005 changes were submitted to CALSTARS, disallowing access to the check writing function for the employee with accounts receivable duties.
- D. In November 2005, changes were submitted to CALSTARS, reassigning backup receipt duties to another employee.
- E. In November 2005, the conflict was corrected for one of the units. Corrections for the remaining two units will be completed in December 2005.

Finding 3

Reconciliations Are Not Performed Regularly

Recommendation: Perform reconciliations that attest to the accuracy of accounting records on a regular basis. Specifically:

- A. Perform SCO/CALSTARS reconciliations on a monthly basis within 30 days of the preceding month to prevent long-outstanding differences.
- B. Perform reconciliations between subsidiary records and the general ledger uncleared collection account on a monthly basis.
- C. Perform reconciliations between manual tracking of Judicial Council expenditures to the general ledger expenditure account on a monthly basis.

Response:

- A. Reconciliations are performed on a monthly basis. In the event there are staffing shortages, completion of the reconciliations may be delayed.
- B. DCSS concurs and has implemented the recommendation. DCSS developed and implemented a formal reconciliation of subsidiary records to CALSTARS prior to the completion of this audit. The reconciliation has been performed for July, August and September 2005. Uncleared collections, reported on the year-end financial statements, have been reviewed and determined to be correct.
- C. DCSS believes the current process to track Judicial Council advances is adequate. In accordance with CALSTARS procedures, advances are recorded as expenditures. The DCSS records the advance-expenditures to an isolated index code for tracking purposes. These expenditures are reconciled to the subsidiary records.

Finding 4 Inadequate Documentation of Authorization Signatures

Recommendation: Establish, maintain, and update a list of Department staff that are authorized to approve purchases, purchase adjustments, and contracts for goods and services.

Response: DCSS concurs and has implemented the recommendation. A new Signature Authorization form, and companion procedures calling for annual renewals, has been implemented. Its purpose is to identify Department personnel authorized to approve and sign contracts and procurement documents. For audit and control purposes, the Business Services Section will maintain the signed originals.

Finding 5 Contingency Receivables Due From Counties Are Not Established

Recommendation: Ensure all receivables are properly recorded in the Department accounting records. The Department does not establish a receivable in CALSTARS for contingency receivables due from county audit findings. The Department records any collection of contingency receivables from counties as revenue.

Response: DCSS concurs and has implemented the recommendation. Procedures have been adjusted to change valid receivables to contingent receivables as appropriate. The Department will also begin to record county receivables upon receipt of audit findings.

Finding 6 Inadequate Collection Procedures for Employee Account Receivables

Recommendation: Employee account receivables are not cleared timely. Ensure all receivables are properly monitored and that appropriate action is taken.

Response: DCSS concurs and has implemented the recommendation. In October 2005, written procedures were established.

Finding 7 Inadequate Controls Over Fixed Assets

- Recommendation:** Ensure accounting and physical controls over fixed assets are in place. Specifically:
- A. Perform and document an inventory on all Department property once every three years
 - B. Ensure the physical inventory is reconciled to subsidiary ledgers and to the Statement of General Fixed Assets general ledger.
 - C. Institute property tagging policies and procedures that comply with SAM requirements to tag all property, including non-IT items, with sequentially numbered property tags. Business Services should identify property ordered that requires property tags.
 - D. Formalize a list of the Property Survey Board members and provide the list to employees who complete the property survey reports.

Response: The Business Services Section is in the process of establishing and implementing SAM-compliant policies and procedures for the physical inventory maintenance, reconciliation, and property tagging of all non-IT property. These procedures will be incorporated in the administrative manual. In addition, the IT Division currently performs physical inventory maintenance, reconciliation, and property tagging of all IT equipment. The Accounting Section reconciles the physical inventories to the fixed asset ledger.

- A. DCSS concurs. The policies and procedures currently being developed will include a list of all items that need to be tagged upon receipt of purchase. The Business Services Section recently completed a current inventory listing of all departmentally owned non-IT property. As recommended, a new inventory listing will be developed and an inventory conducted every three years. Items that no longer exist will be reconciled with a Property Survey Report.
- B. The Department reported general fixed assets correctly. Although a system for tracking non-IT equipment was not established, the Accounting Section was able to access equipment records from various sources to perform a reconciliation. In the future when a non-IT equipment inventory list is established, the Accounting Section will use both the IT and non-IT lists to make comparisons and reconcile the general fixed asset account.
- C. DCSS concurs and has implemented the recommendation. The Business Services Section recently completed a current inventory listing of all departmentally owned non-IT property. All non-IT items over \$250 were accounted for and tagged.

- D. Prior to the exit conference, the Business Services Section manager provided the DOF auditors with a recently updated Property Survey Board document. This updated document, in addition to updated processes and procedures for property surveying, will be distributed to all staff who complete property survey reports, and will be included in the administrative manual.

Finding 8 Inadequate Risk Management Analysis and Reporting

Recommendation: Contact Department of Finance's Office of Technology Review Oversight and Security to obtain advice in completing Risk Management Analysis and reporting the annual Certification.

Response: DCSS concurs and has implemented the recommendation. DCSS recently hired an Information Security Officer (ISO). The ISO is working directly with the Department of Finance, Office of Technology Review Oversight and Security (OTROS) director to facilitate development of DCSS' Risk Management Analysis for the department. The ISO is developing the work plan that includes a timeline for completion and submission to OTROS.

Finding 9 Staff Do Not Lock Computers

Recommendation: Enforce the Department Information Security Policy to ensure data integrity by locking computers when leaving the workstation.

Response: DCSS concurs and has implemented the recommendation. During the month of October 2005, DCSS undertook an initiative to present Security Awareness training for all DCSS employees and contractor staff. Security Awareness training sessions were provided to all staff on a mandatory attendance basis. Staff were exposed to the importance of locking their computers when away from their work area, in addition to being provided with appropriate instructions. The security message will be reinforced in future annual training, in posters, in broadcast messages to all staff, and through other planned initiatives.

Finding 10 Lack of Supervisory Review of Deposits

Recommendation: Implement a supervisory review of deposits.

Response: DCSS concurs and has implemented the recommendation. Supervisory review over the deposit process was implemented in August 2005. In addition, the cashiering function was transferred to the Accounting Section on November 1, 2005. Procedures have been updated accordingly.

- Finding 11** **Invoices Approved for Payment without Stock Received Reports**
- Recommendation:** Ensure stock received reports are prepared upon receipt of goods and submitted to the Business Services Division for approval of invoice payments.
- Response:** DCSS concurs. The Business Services Section is currently developing new processes and procedures for receiving all tangible orders. These procedures will be implemented, monitored for compliance and accuracy, and included in the administrative manual.
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- Finding 12** **Incomplete Employee Separation Process**
- Recommendation:** Require that all separating employees complete the separation package before the employee is cleared to leave the Department. Accounting must ensure that all outstanding advances are cleared and the employees' supervisor must ensure all equipment assigned to the employee is returned. Do not issue warrants to separating employees unless the separation process is completed.
- Response:** DCSS concurs and has implemented the recommendation. Human Services will ensure that an Employee Separation Package is completed by all separating employees. In addition Separation Package policies and procedures will be revised and distributed to management and Attendance Coordinators. Human Services will forward the Employee Separation Package to Accounting who will review for outstanding travel and salary advances and return to Human Services. The last salary warrant will be adjusted as authorized by SAM 8580.4.
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- Finding 13** **Employee Leave Balances Exceed Maximum Allowable Hours**
- Recommendation:** The Department should monitor employee leave balances on a regular basis to ensure authorized levels are not exceeded. The Department should schedule and enforce vacation schedules for employees exceeding the maximum leave balances allowed.
- Response:** DCSS concurs and has implemented the recommendation. The Department will continue to follow its practice to monitor all employee leave balances. Employees identified as exceeding the applicable regulatory or collective bargaining accrual maximum provisions will continue to be required to submit a written leave balance liquidation plan for supervisor approval.
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- Finding 14** **Noncompliance with the State Contract Manual Requirements**
- Recommendation:** The Department should comply with the State Contract Manual (SCM) requirements. Specifically:

- A. Ensure that the applicable SCM requirement for multiple contracts with same vendor is followed.
- B. Obtain adequate signatures for legal documents.
- C. Ensure that applicable SCM requirements for notifying the Department of Fair Employment and Housing (DFEH) are followed.

Response:

DCSS concurs. The Department is in process of developing a centralized contract administration function to incorporate fiscal support and contract monitoring.

- A. The Contracts Manager is currently reviewing all DCSS contracts for noncompliance of SCM regulations with regard to splitting service contracts. It is our understanding that splitting the contract was not the intent, but that different needs were identified after the execution of one contract. All future contracts developed by the DCSS Contracts Unit will be thoroughly scrutinized prior to engaging in processing a new contract with the same vendor to ensure compliance with SCM regulations.
- B. The Contracts Manager is currently developing processes and procedures, as well as checklists, to ensure that all contracts follow the appropriate signature authorization process prior to execution. After researching contract files, the Contracts Manager discovered that the three contracts listed as not having contractor signature, did in fact contain the signature(s) of the contractor(s). However, in all three cases, the paperwork was improperly filed with the backup documentation of the specific contract.
- C. The Contracts Manager will ensure that applicable SCM requirements for notifying DFEH are included in the new contracts processes and procedures, as well as on the contracts checklist. Additionally, a requirement that a final review of each and every contract file is conducted at the execution stage is being implemented. These mandatory requirements will be included in the Contracts section of the administrative manual.

EVALUATION OF DEPARTMENT RESPONSE

We are in receipt of the Department of Child Support Services' (Department) response dated January 6, 2006, to our draft audit report on the Department's internal controls. We have incorporated the response into our final report. We acknowledge the Department's prompt steps to implement and address Department of Finance's (Finance) recommendations during the audit. Finance is encouraged to see such prompt and proactive response to its recommendations. Upon review of the Department's response, we provide the following comments.

The Department either provided clarification or concurred and provided corrective actions for 13 of the 14 findings noted in our draft report. The Department disagrees with Findings 3 A and C regarding reconciliations not being performed timely. After reviewing the Department's response, we maintain our position as stated in our report, and recommend the Department develop and implement corrective actions to resolve these issues. While Finance understands that external factors such as staffing shortages may cause delays in otherwise normal routines; however, steps should be taken to ensure that reconciliations are completed within the 30 days proscribed by the State Administrative Manual.